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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 534

ESTATE OF HENRY W. PUTNAM, DECEASED, GUARANTY TRUST COMPANY OF NEW YORK, EXECUTOR,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 31-38) is reported at 45 B. T. A. 517. The opinion of the Circuit Court of Appeals (R. 67-72) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 25, 1944 (R. 72-73). The petition for a writ of certiorari was filed on October 2, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether dividends declared before the death of an individual stockholder but payable by the terms of the declaration to stockholders of record on dates which fell after his death accrued prior to the date of death within the meaning of Section 42 of the Revenue Act of 1938 so that they are includable in income for the taxable period in which fell the date of death.

STATUTE INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period.

STATEMENT

The facts were found by the Board of Tax Appeals as stipulated (R. 33). They may be summarized as follows:

Henry W. Putnam died on March 30, 1938, a resident of New York City. On the date of his death he owned shares of stock in New Jersey, Delaware, Pennsylvania, and Maine corporations. Prior to his death, each of these corporations declared cash dividends which were payable to stockholders of record on dates subsequent to the date of death and paid to the executor of Putnam's estate after his death. (R. 33-35.)

Decedent's executor filed an income tax return for the estate for the period from March 30, 1938, to December 31, 1938, and included as income therein a dividend of \$2,400 declared and paid by American Smelting & Refining Company, one of the New Jersey corporations. The executor also filed an income tax return for the decedent for the period from January 1, 1938, to March 30, 1938, and included therein the dividends, totaling \$21,651.75, declared and paid by the other corporations, two of which were organized in New Jersey, and the remainder in Delaware, Pennsylvania, and Maine.¹ (R. 35-36.)

The Commissioner determined a deficiency against the decedent for the period January 1, 1938, to March 30, 1938, on the ground in part that the dividend of \$2,400, which the estate had

¹ A schedule showing the corporations, states of incorporation, amounts of the dividends, the dates on which the dividends were declared and paid, and the record dates thereof, appears in footnote 1 of the opinion of the Circuit Court of Appeals (R. 68).

treated as its income for the later period, should be included in decedent's income for the period prior to his death (R. 24-27). However, in order to protect himself against an adverse decision, the Commissioner also determined a deficiency against the estate for the period from March 31, 1938, to December 31, 1938, on the ground in part that the dividends of \$21,651.75 should be included in the income of the estate for this period (R. 11-14). The executor appealed to the Board of Tax Appeals from both determinations (R. 5-10, 18-23). The cases were consolidated for hearing and decision (R. 32).

The Board held (R. 36-38), five members dissenting without opinion, that the dividends of the New Jersey corporations, amounting to \$20,700, constituted income accrued prior to March 30, 1938, and should be included in the decedent's income for the period January 1, 1938, to March 30, 1938, from which conclusion the executor petitioned for review (R. 52-57). The Board also held that the dividends of the Delaware, Pennsylvania, and Maine corporations, totaling \$3,351.75, accrued subsequent to the date of death and constituted income of the estate, from which conclusion the Commissioner petitioned for review (R. 41-46).

The Circuit Court of Appeals decided, Judge Learned Hand dissenting, that the dividends of all the corporations accrued on the date on which they were declared and should be included in in-

come for the period in 1938 prior to the date of death (R. 67-72).

ARGUMENT

The controlling statute is Section 42 of the Revenue Act of 1938, *supra*, p. 2, which provides for the inclusion in the income of a deceased taxpayer for the taxable period in which occurs the date of his death, of amounts which have accrued up to the date of death, if not otherwise properly includible in that period or in a prior period. In *Helvering v. Enright*, 312 U. S. 636, this Court held that the word "accrued" in Section 42 was used in a broader sense than the term "accrued" in Section 48 in connection with the accrual method of accounting and that Section 42 is to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return would appear in the returns for the estate.² See also *Pfaff v. Commissioner*, 312 U. S. 646. The Circuit Court of Appeals decided in this case that the dividends,

² The object of Section 42, first enacted in the Revenue Act of 1934, was to require the inclusion of all amounts accrued up to the date of death regardless of the fact that the decedent may have kept his books on the cash basis. Decisions (see particularly *Nichols v. United States*, 64 C. Cls. 241; *Vanderbilt v. Commissioner*, 11 B. T. A. 291) had established that such income was not taxable to the estate when received but was a part of the corpus, and unless it was taxable in the period prior to the date of death, it escaped in-

declared prior to death but payable and paid to stockholders of record on a date subsequent to the date of death, "accrued" within the meaning of Section 42 prior to death. For the following reasons, we believe that review of its decision is not warranted.

1. The decision does not conflict with *Tar Products Corp. v. Commissioner*, 130 F. 2d 866 (C. C. A. 3d), as petitioner asserts (Pet. 5, 17-18). The question in that case was whether the Tar Products Corporation, which reported its income under the accrual basis of accounting, should report a dividend as income of the year in which it was declared or as income of the year in which it was payable and was paid. The court applied a

come tax altogether. H. Rep. No. 704, 73d Cong., 2d Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 554, 572); S. Rep. No. 558, 73d Cong., 2d Sess., p. 28 (1939-1 Cum. Bull. (Part 2) 586, 608). The case of *Sharp v. Commissioner*, 91 F. 2d 802 (C. C. A. 3d), reversed on other grounds, 303 U. S. 624, takes a different view; it was there held that a dividend declared prior to a decedent's death but payable to stockholders of a record date subsequent to death and paid to his executors after his death constituted income rather than corpus and was not includible in the gross estate; the executors had reported the dividend as income of the estate and this treatment of the dividend was allowed to stand under the decision. However, the case does not constitute authority that the dividend in the case at bar would properly be reported as income for the period after death. The *Sharp* case arose under the Revenue Act of 1926 which did not contain Section 42 or its equivalent. Consequently, the issue was not presented as to whether the dividend accrued prior to death within the meaning of Section 42.

long-standing regulation³ providing that a taxable distribution by a corporation shall be included in the gross income of the distributees when the cash or other property is "unqualifiedly made subject to their demands" and held that the dividend was not includible in income at the time it was declared, because it was not then unqualifiedly subject to the demand of the stockholder.⁴ The court pointed out that the regulation makes no distinction between cash and accrual basis taxpayers, and that it therefore establishes the same criterion for both to determine when a dividend shall be included in income.⁵

In the *Tar Products* case, however, the court did not consider the question of when the dividend "accrued" within the meaning of Section 42, and in effect held that the question of accrual was irrelevant in view of the regulation. But Section

³ Article 115-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936. The same provision appeared first as Article 1541 of Treasury Regulations 62, promulgated under the Revenue Act of 1921, and also was in force in the year in question in this case as Article 115-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938.

⁴ This Court had already reached a similar conclusion under the same provision of an earlier regulation where the taxpayer was on the cash receipts and disbursements basis of accounting. *Avery v. Commissioner*, 292 U. S. 210.

⁵ The Tax Court has followed this decision in *American Light & Traction Co. v. Commissioner*, 3 T. C. 1048, overruling by implication its earlier contrary decision in *Campbell v. Commissioner*, 6 B. T. A. 60.

42 makes accrual the determining factor in cases such as the instant one involving a decedent's income, and it is not to be tested by ordinary principles governing the time for taxation of dividends.⁶ Because different statutory provisions are involved there is no inconsistency in result between the *Tar Products* case and the instant one. In fact the same court which decided the *Tar Products* case approached the matter differently in a case arising under Section 42. See *Bach v. Rothensies*, 124 F. 2d 306 (C. C. A. 3d), certiorari denied, 316 U. S. 666, holding that dividends had accrued at the date of death of a trust beneficiary within the meaning of Section 42, even though they had not been paid to the trust of which the decedent was a beneficiary and even though the trust agreement expressly prohibited the payment of income to beneficiaries prior to collection.

2. The judgment below is in accord with the result in all cases which have considered when a dividend "accrues" within the meaning of Section 42. See *Commissioner v. Cohen*, 121 F. 2d 348 (C. C. A. 5th); *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.). The *First Nat. Bank* case expressly holds that a divi-

⁶ Section 115 (a) of the Revenue Act of 1938, referred to by petitioner (Pet. 13, 17), simply defines a dividend for income tax purposes. It has no relevance here, since there is no question that the amounts involved in this case were dividends.

dend accrues within the meaning of Section 42 to the stockholder at the time it is declared, regardless of the fact that the stockholder may have died before the record date. The *Cohen* case holds that the date of declaration determines the accrual date of a dividend and implies that the record date is irrelevant, since the Texas cases cited by the court (121 F. 2d at p. 349) did not give any effect to the record date. While the court concluded in the *McGlue* case under the law of New York that the record date of a dividend was merely for the convenience of the corporation, its decision (119 F. 2d at p. 175) rests on the fact that the declaration of the dividend created a debt and that the stockholder's right to the dividend accrued at that time.⁷

3. The judgment below correctly applies Section 42, as interpreted by this Court in *Helvering v. Enright*, 312 U. S. 636, in treating the dividends declared prior to the date of decedent's death as

⁷ It is agreed by the court below and the parties in this case that the question of when a dividend accrues under Section 42 requires a single test to be uniformly applied and is not to be decided by the law of the state in which the corporation declaring the dividend is formed. Cf. *Lyeth v. Hoey*, 305 U. S. 188. We believe that the court in *Helvering v. McGlue's Estate*, 119 F. 2d 167 (C. C. A. 4th), reached the correct decision but to the extent that its conclusion is based upon the theory that local law controls the result, we think it erroneous. The Board's opinion in this case (R. 36-38) is also predicated on the belief that the law of the domicile of the corporation which declared the dividend is controlling as to when a dividend accrues under Section 42.

"accrued" prior to the date of death. Even under ordinary principles of accrual accounting, income accrues and is taxable when events have occurred to fix the amount due and determine the liability to pay. *Spring City Co. v. Commissioner*, 292 U. S. 182, 184-185, rehearing denied, 292 U. S. 613; *Continental Tie & L. Co. v. United States*, 286 U. S. 290; *H. Liebes & Co. v. Commissioner*, 90 F. 2d 932 (C. C. A. 9th); cf. *United States v. Anderson*, 269 U. S. 422; *Brown v. Helvering*, 291 U. S. 193. Independently of a regulation to the contrary, it might well be held that even for ordinary accrual purposes, a dividend accrues when declared, since the resolution declaring the dividend fixes the amount due with certainty and also fixes the liability to pay. But clearly that should be the rule under Section 42 as interpreted in the *Enright* case. The declaration created a debtor-creditor relationship between the corporation and the stockholder, corporate earnings were appropriated for payment of the dividend, and the dividend was irrevocable, once the declaration was communicated to the stockholders. *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th); *Carney v. Crocker*, 94 F. 2d 914 (C. C. A. 1st); *Flynn v. Haas Bros.*, 20 F. 2d 510 (C. C. A. 9th); *United States v. Guinzburg*, 278 Fed. 363 (C. C. A. 2d); *First Nat. Bank & Trust Co. v. Glenn*, 36 F. Supp. 552 (W. D. Ky.); *Beattie v. Gedney*,

99 N. J. Eq. 207, 211-212; *McLaran v. Planing Mill Co.*, 117 Mo. App. 40; *Northwestern Marble & Tile Co. v. Carlson*, 116 Minn. 438; *Hopper v. Sage*, 112 N. Y. 530; Kehl, Corporate Dividends (1941) 184-185; 11 Fletcher, Cyclopedic of Corporations (Perm. ed., 1932), Sec. 5322. And a corporate debt is created upon declaration even though the dividend may be payable on a future date to stockholders of record on a future date; the record date is a mere convenience to the corporation to protect it in paying dividends. *Lamberth v. Commissioner*, 120 F. 2d 101, 105 (C. C. A. 9th); *Realty Inv. Co. v. Moore*, 104 F. 2d 716 (C. C. A. 6th); *Ford v. Snook*, 205 App. Div. 194, affirmed *per curiam*, 240 N. Y. 624; *Beattie v. Gedney*, 99 N. J. Eq. 207; Note, 38 Harv. L. Rev. 245 (1924). It is true that Connecticut and Massachusetts courts, in cases⁸ involving a contest over a dividend, have held that the owner of stock on the record date is entitled to the dividend rather than the owner on the date of declaration, but these cases do not hold that a dividend once declared may be rescinded. Accordingly, they do not affect the conclusion that the liability to pay has become inalterably fixed.

⁸ *Union & New Haven Trust Co. v. Watrous*, 109 Conn. 268; *Richter & Co. v. Light*, 97 Conn. 364; *Nutter v. Andrews*, 246 Mass. 224. See also dicta in *Ford v. Ford Manufacturing Co.*, 222 Ill. App. 76; *Opperman's Estate (No. 1)*, 319 Pa. 455.

Moreover, the dividends are presumed to have been declared out of profits earned by the corporation prior to the date of declaration (see *Commissioner v. Cohen*, 121 F. 2d 348, 349 (C. C. A. 5th)), during a time when the decedent was a stockholder, and if all other factors remained equal, the mere declaration of the dividend would have increased the market price for decedent's stock by the amount of the dividend. Thus from an economic and practical point of view, the dividend accrued to the decedent in the form of a material benefit and was fully earned during his lifetime. Cf. *Helvering v. Enright*, 312 U. S. 636.

The argument that the dividend does not accrue because the person who will receive it is unknown on the date of declaration is without merit. The stockholder on the date of the declaration, as the stockholder of record at that time, acquires a right to the dividend and will receive it unless the corporation is notified prior to the record date that a different stockholder owns the stock. The incumbent stockholder can fail to receive the dividend in cash only if he transfers the stock or dies prior to the payment date. But in neither case will he lose the benefit of the dividend. If he sells, he will secure a higher price for his stock because of the dividend; and if he dies, his estate takes the stock, plus the right to the dividend which it later receives in cash.

4. The question involved in this case is not likely to be of great importance in the future because of the provisions of Section 134 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798. That Section eliminates the accrual of income solely by virtue of a decedent's death and substitutes a provision whereby such items are taxed as income to the persons receiving such amounts by inheritance or survivorship. Similarly, deductions are no longer accrued to the decedent as provided in Section 43 of the Revenue Act of 1938 but may be taken by those persons who receive the income to which the deductions are related.* These provisions apply in terms to taxable years commencing after December 31, 1942, but they could be made retroactive to January 1, 1934, in any case at the option of taxpayers provided they filed consents prior to January 1, 1944. See Section 134 (g) of the Revenue Act of 1942; Treasury Regulations 103, Section 19.126-4 (b), as added by T. D. 5233, 1943 Cum. Bull. 198, 208; Treasury Regulations 111, Section 29.126-4. Although Section 134 is not applicable in this case because the estate has filed no consent, its provisions have been available to other taxpayers. Consequently the question posed by this case seems largely of academic interest.

* One of the purposes of Section 134 was to eliminate the hardship of pyramiding income in the period in which death occurred. See the detailed discussion of this complex provision in H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88, and S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105.

CONCLUSION

There is no conflict of decisions. The instant case was correctly decided in accordance with the controlling statute and decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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OCTOBER 1944.

